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Products Liability Insurance Coverage

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PRODUCTS LIABILITY INSURANCE COVERAGE

Over the last two decades, society has witnessed tremendous growth in the legal concepts of products liability. This growth and its accompanying turmoil have been the result of three primary factors:[1] (1) the development of the rule of *MacPherson v. Buick Motor Co.*[2] extending manufacturers', contractors' and vendors' liability for negligence related to product- and work-caused injuries to persons outside the contractual relationship; (2) the expansion by statutes and judicial decisions of the warranty liability of manufacturers and vendors to third persons;[3] (3) the effectuation by judicial decision[4] and legislative enactment[5] of strict liability in tort. In our modern society, potential for injury has so increased that it is difficult to conceive of an American who is not exposed to some type of product-related injury. The owner, vendor, distributor and manufacturer of the source likewise are exposed to a correlative liability.[6] Such liability may arise in negligence, breach of warranty or strict liability in tort. As this trend toward stricter liability continues,[7]

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1. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3500.

2. 217 N.Y. 382, 111 N.E. 1050 (1916).

3. *See, e.g.*, Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

4. *E.g.*, Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962).

5. *E.g.*, S.C. CODE ANN. § 15-73-10 (1976).

6. *See generally* Hendersen, *Insurance Protection for Products Liability and Completed Operations—What Every Lawyer Should Know*, 50 NEB. L. REV. 415 (1971).

7. Tennessee recently enacted a statute imposing strict liability in tort. TENN. CODE ANN. §§ 23-3705, -3706 (Cum. Supp. 1978).

The proposed draft of the Uniform Products Liability Act states as follows:

> [I]t is important to understand the basic philosophy that underlies the model product liability law. Product liability law is a branch of the law of torts. The function of tort law is to shift the cost of an accident from a claimant to a defendant when that person is deemed "responsible" for the claimant's injuries. This responsibility should be defined in terms that everyone can understand. It should indicate why a particular individual product seller should bear the cost of that injury.
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> Tort law is not a compensation system similar to Social Security or Worker Compensation. A product seller is not being asked to pay merely because his product caused an injury. If that were the case, it would be far more efficient and less expensive to make purchasers of products third-party beneficiaries of product sellers' insurance policies and provide a limited damages recovery, as is the case with other compensation systems. In sum, product liability law should impose liability only where it is fair to deem the product seller responsi-

businessmen increasingly have become interested in protecting themselves against the serious financial burden that accompanies the potential liability from product claims. The result has been that products liability insurance swiftly has become one of the major forms of liability insurance.[8]

The insurance industry has sought to keep abreast of these changes in the field of products liability. The increase in products liability litigation has caused insurers to give particular attention to the problems that arise when a products liability case is litigated and coverage questions are raised.[9] The insurance industry has refined descriptions of the circumstances under which the risk of loss resulting from products and operations will be insured.[10] The National Bureau of Casualty Underwriters adopted the revised standard provisions for Comprehensive General Liability (CGL) insurance, which became effective October 1, 1966.[11] It is these revisions, among others,[12] that this Note will address. It should be emphasized that the phrase "products liability insurance," will be used in its broadest sense encompassing not only liability insurance for consumer product-related injuries, but also similar insurance for builders, contractors and other providers of product-related operations.

Primary focus will be on the cases that construe those provisions of the standard products liability policy that were introduced or revised in 1966. To understand and appreciate fully these revisions and interpretations, however, a brief analysis of the development of, and the problems that plagued, the pre-1966

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ble for an injury.
44 Fed. Reg. 2996, 2997 (1979).

8. Andersen, *Current Problems in Products Liability Law and Products Liability Insurance*, 31 INS. COUNSEL J. 436, 441 (1964). "In the present climate of the law, many modern manufacturers have retreated from their former status as self-insurers. Products liability insurance, cautiously and hesitantly written shortly before the mid-twenties, as the result of demands of manufacturers for coverage, now has become a major phase of insurance underwriting." Miller, *Liability of a Manufacturer for Harm Done by a Product*, 3 SYRACUSE L. REV. 106, 124 (1951).

9. Andersen, *supra* note 8, at 436.

10. Sorensen, *The New Comprehensive General Liability Policy's Products Liability Coverage*, 1966 INS. L.J. 645, 645.

11. *See* Elliott, *The New Comprehensive General Liability Policy*, in LIABILITY INSURANCE DISPUTES 12-3 (S. Schreiber ed. 1968).

12. In 1973 the standard CGL policy was again amended, although to a lesser extent than in 1966. The major 1973 changes were the inclusion, unless specifically excluded, of products-hazard and completed-operations coverages and a rewording of the business-risk exclusion. *See* 1 R. LONG, THE LAW OF LIABILITY INSURANCE § 11.01 (Cum. Supp. 1979).

standard policy is in order. Attention will then shift to the products-hazard and completed-operations provisions as they appear after October 1966, as well as to various exclusions that were introduced or reworded at that time. This Note also will treat the ways in which courts have addressed coverage issues dealing with time of loss and warranties. The author hopes that through a better understanding of the provisions and the ways in which they are currently being construed by the courts, the practitioner will be able to effectively advise the business client in his or her search for affordable yet comprehensive coverage against product- and service-related claims.

I. DEVELOPMENT

The development of insurance protection for products liability has coincided with the development of modern tort theories of products liability.[13] One writer states that the first products liability insurance, known as poison insurance, was written in England around 1890 to insure pie bakers against liability for accidents that occurred when roach powder inadvertently got into the pie dough.[14] It was not until the late 1930s, however, that the common law in this area began to develop and products liability insurance began its rise to prominence as one of the major forms of liability insurance.[15] Prior to this time, there simply was little need for such insurance coverage. Before the creation of liability for injuries arising from unreasonably dangerous products, the manufacturer could be sued only for negligence or breach of warranty.[16] Furthermore, even if the plaintiff could obtain the necessary evidence to sustain a claim for breach of warranty, until recently he had to contend with the privity barrier.[17] The greatest risk that a manufacturer might face, aside from liability to

13. Hendersen, *supra* note 6, at 416. Several cases have pointed out the development. *See, e.g.*, Liberty Mut. Ins. Co. v. Hercules Powder Co., 224 F.2d 293 (3d Cir. 1955); Nielson v. Travelers Indem. Co., 174 F. Supp. 648 (N.D. Iowa 1959), *aff'd*, 277 F.2d 455 (8th Cir. 1960).

14. Andersen, *supra* note 8, at 441.

15. *Id.*

16. Hendersen, *supra* note 6, at 417.

17. In Gasque v. Eagle Machine Co., 270 S.C. 499, 243 S.E. 2d 831 (1978), the South Carolina Supreme Court, interpreting S.C. CODE ANN. § 36-2-318 (1976), dispensed with the need for contractual privity between a component part manufacturer and a plaintiff in cases of injury and damage to person or property. *See generally Products Liability, Annual Survey of South Carolina Law*, 31 S.C.L. REV. 101, 101-05 (1979).

employees, "was for injuries to third persons arising out of operations or activities on or near his premises and for operations away from such premises but related thereto."[18] This liability arising from activities in progress was covered by public liability policies, readily available under the "Premises and Operations" coverage.[19]

If, however, the injury arose after completion of the work or operations, and away from the described premises, there was no coverage.[20] Therefore, with the rise of strict liability and the fall of the privity requirements, an additional coverage became necessary. The insurance industry responded with products-hazard coverage, which dealt with two product-oriented situations: (1) injuries, arising from goods or products, that occur away from the insured's premises and after the insured has relinquished possession of the products; and (2) injuries resulting from operations occurring away from the insured's premises and after the operation has been completed. The industry chose to place both coverages under the heading "Products Hazard," which, as will be shown below, caused confusion and differences of opinion in the courts, as well as among even the most reputable underwriters.[21]

II. PRE-1966 PRODUCTS LIABILITY INSURANCE

The principles that the courts used and the problems they experienced in addressing pre-1966 policy coverage issues still play a significant role in construing the revised policy language. Thus, it is necessary to analyze briefly how courts dealt with these pre-1966 principles and problems.

For more than twenty years prior to 1966, the products-hazard coverage provision of the ordinary standard liability policy was very similar, if not identical, to the following:

Products Hazard

(1) The handling or use of, the existence of any condition

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18. Hendersen, *supra* note 6, at 417.

19. For a general discussion of premises and operations coverage, see 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE §§ 4493.2-.3 (1962).

20. *See, e.g.*, Kelly-Dempsey & Co. v. Century Indem. Co., 77 F.2d 85 (10th Cir. 1935); Graustein & Co. v. Employers' Liab. Assur. Corp., 214 Mass. 421, 101 N.E. 1073 (1913); Camden & Atl. Tel. Co. v. United States Cas. Co., 227 Pa. 242, 75 A. 1077 (1910).

21. Callahan, *"Completed Operations" Exclusions in General Liability Policies*, 1 FORUM 16, 16 & n.1 (Jan. 1966).

in or a warranty of goods or products manufactured, sold, handled or distributed by the named insured, other than equipment rented to or located for use of others but not sold, if the accident occurs after the insured has relinquished possession thereof to others and away from the premises owned, or controlled by the insured or on the premises for which the classification in division 1 of the declarations excludes any part of the foregoing;

(2) Operations: If the accident occurs after such operations have been completed or abandoned at the place of the occurrence thereof and away from the premises owned, rented or controlled by the insured, except (a) pickup and delivery, (b) the existence of tools, uninstalled equipment and abandoned or unused materials and (c) operations for which the classification stated in division 1 of the declarations specifically includes completed operations; provided, operations shall not be deemed incomplete because improperly or defectively performed or because further operations may be required pursuant to a service or maintenance agreement.[22]

This coverage was not automatically incorporated as part of the general comprehensive liability policy. Rather, the manufacturer, vendor, or others engaged in the sale and distribution of products or the supply of an operation had to purchase this coverage for an additional premium. When this additional premium was paid, the products-hazard coverage was included, normally by endorsements or riders.[23]

In interpreting and applying the coverage in the first paragraph of the "Products-Hazard" division, courts encountered little difficulty since the meaning and intent of this subdivision were unambiguous. The exclusion of subdivision (1) coverage relieved the insurer of the duty to defend and pay judgment when the insured was sued in strict liability, negligence or breach of warranty, if the accident out of which the suit arose occurred after the insured had relinquished possession of the injury-causing merchandise and the injury occurred away from the insured premises.[24] If the product had not been relinquished or had not

22. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3530.

23. *Id.*

24. *Id.* ¶ 3526. *See also* Bitts v. General Acc. Fire & Life Assur. Corp., 282 F.2d 542 (9th Cir. 1960)(exploding refrigerator); Orchard v. Agricultural Ins. Co., 228 F. Supp. 564 (D. Or. 1964), *aff'd*, 340 F.2d 948 (9th Cir. 1965)(sale of wrong axle bearing); Lyman Lumber & Coal Co. v. Travelers Ins. Co., 206 Minn. 494, 289 N.W. 40 (1939)(shipment of

been removed from the insured's premises, the exclusion was inapplicable and claims for bodily injury and property damage caused by the product fell under the coverage provided by the insured's premises and operations policy.[25]

The construction and application of the coverage provided in subdivision (2) of the "Products-Hazard" division, however, caused problems for courts. The purpose of the exclusion of completed operations, if products-hazard coverage was not purchased additionally, was to relieve the insurer of the duty to defend and pay judgment on suits arising out of accidents that occurred after the insured had finished the "operation," even though the accident resulted from some negligent act or omission committed while the work was actually in progress.[26] The definitions of "operations" and "use or handling" of products somewhat overlap, since the use or handling of goods or products that an insured manufactures, sells, handles, or distributes necessarily includes some form of operation. The courts found no difficulty in determining what was meant or intended by the completed-operations exclusion when the cases before them involved only the manufacture, sale or distribution of a "product."[27] Not all operations, however, involve a product and herein lay the difficulty. The courts were unable to agree on the scope of the completed-operations exclusion when applied to pure service operations. In *Nielson v. Travelers Indemnity Co.*[28] the court aptly described the dilemma:

> Where the transaction involves . . . the erection of a structure and the contractor furnishes material for the structure, greater difficulty is encountered as to the liability insurance coverage under the products hazard provision. However, when the contract involves . . . the rendering of services which do not in-

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coal); Inductotherm Corp. v. New Jersey Mfrs. Cas. Co., 83 N.J. Super. 464, 200 A.2d 358 (Super. Ct. Law Div. 1964)(defective crucibles); Blohm v. Glens Falls Ins. Co., 231 Or. 410, 373 P.2d 412 (1962)(defective lawn mower).

25. Such coverage was also provided in "Owners, Landlords and Tenants," "Manufacturers and Contractors," "Schedule Liability" and "Garage Liability" policies. 1 R. LONG, *supra* note 12, § 11.01 (1978); Arnold, *Products Liability Insurance*, 1957 WIS. L. REV. 429, 430 (1957).

26. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3530.

27. *E.g.*, Smedley Co. v. Employers Mut. Liab. Ins. Co., 143 Conn. 510, 123 A.2d 755 (1956); Cobbins v. General Acc. Fire and Life Assur. Co., 53 Ill. 2d 285, 290 N.E.2d 873 (1972).

28. 174 F. Supp. 648 (N.D. Iowa 1959), *aff'd*, 227 F.2d 455 (8th Cir. 1960).

> volve the furnishing or supplying of any product or material, the question of liability insurance coverage under the products hazard provision becomes most difficult.[29]

Since the coverage afforded by a liability insurance policy is measured not by what is given by the insuring agreement, but rather by what is left after all the exclusionary provisions have been given proper effect,[30] courts had to find some way to deal with the problem. Some simply gave up, as did the Seventh Circuit Court of Appeals when it was faced with the question of the insurer's liability under the completed-operations clause for the negligence of the insured contractor:

> The true meaning of the policy is difficult to determine. An examination of it involves a physical effort of no mean proportions. Starting out with three printed pages, the first of which consists largely of a form which is filled in on a typewriter, the reader is confronted also with six physically attached supplements, or riders, inconveniently assorted into different sizes. If he is possessed of reasonable physical dexterity, coupled with average mental capacity, he may then attempt to integrate and harmonize the dubious meanings to be found in this not inconsiderable package. A confused attempt to set forth an assuring agreement is later assailed by such a bewildering array of exclusions, definitions and conditions, that the result is confounding almost to the point of intelligibleness [sic]. To describe the policy as ambiguous is a substantial understatement.[31]

Most courts took a more pragmatic approach to the problem but, nevertheless, found the policy ambiguous.[32] They emphasized that the policies employed such terms as "Products,"[33]

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29. 174 F. Supp. at 653-54.

30. 1 R. LONG, *supra* note 12, § 11.01.

31. Ocean Acc. & Guar. Corp. v. Aconomy Erectors, 224 F.2d 242, 247 (7th Cir. 1955).

32. *See* Nielson v. Travelers Indem. Co., 174 F. Supp. 648 (N.D. Iowa 1959), *aff'd*, 277 F.2d 455 (8th Cir. 1960); New Amsterdam Cas. Co. v. Addison, 169 So. 2d 877 (Fla. Dist. Ct. App. 1964); Kendrick v. Mason, 234 La. 271, 99 So. 2d 108 (1958); Morris v. Western Cas. & Sur. Co., 421 S.W.2d 19 (Mo. Ct. App. 1967); McAllister v. Century Indem. Co., 24 N.J. Super. 289, 94 A.2d 345 (Super. Ct. App. Div.), *aff'd mem.*, 12 N.J. 395, 97 A.2d 160 (1953).

33. *See* McAllister v. Century Indem. Co., 24 N.J. Super. 289, 94 A.2d 345 (Super. Ct. App. Div.), *aff'd mem.*, 12 N.J. 395, 97 A.2d 160 (1953)(holding excavator's liability insurance was not offered under the heading "Products").

"Products Hazard,"[34] "Products—Completed Operations,"[35] or "Product (including completed operations) Hazard"[36] and interpreted this as intending to exclude the completed operations of an insured whose business activities did not involve products whatsoever.[37] Other factors that the courts noted in finding ambiguity included: (1) the adjunctive arrangement between "completed operations" and "products";[38] (2) the fact that the completed-operations hazard was tied in by format and premium charge with the products hazard in the description-of-risks section of the policy;[39] (3) the inability to provide coverage for completed operations without also insuring products liability;[40] (4) the use of the singular and not the plural in the term products—completed operations "Hazard";[41] (5) the fact that the premium for "Products-Hazard" coverage was calculated primarily by the gross receipts for all products sold in the previous year;[42] and (6) the fact that the policy is worded and arranged so that a reasonable person would be led to believe that coverage was provided for completed operations.[43] These decisions were perplexing to the draftsmen who rightfully felt that they clearly had defined the scope and purpose of completed-operations coverage. Irrespective of the reasoning underlying these decisions, one writer summarized these "anomalous" rulings as simply the result of an uninformed judiciary who are concerned with insur-

34. *See* Insurance Co. of North America v. Electronic Purification Co., 67 Cal. 2d 679, 433 P.2d 174, 63 Cal. Rptr. 382 (1967).

35. *See* Peerless Ins. Co. v. Clough, 105 N.H. 76, 193 A.2d 444 (1963).

36. *See* Clements v. Aetna Cas. & Sur. Co., 15 Ohio Misc. 252, 236 N.E.2d 799 (C. P. Hamilton County 1968).

37. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3540. *See also* New Amsterdam Cas. Co. v. Addison, 169 So. 2d 877 (Fla. Dist. Ct. App. 1964), in which it was held that the "Products Liability—Completed Operations Hazard" exclusionary clause had application only if the insured was a manufacturer of products, and not when the insured is a general electrical contractor engaged in rendering services.

38. New Amsterdam Cas. Co. v. Addison, 169 So. 2d 877 (Fla. Dist. Ct. App. 1969).

39. McNally v. American States Ins. Co., 308 F.2d 438 (6th Cir. 1962).

40. Peerless Ins. Co. v. Clough, 105 N.H. 76, 193 A.2d 444 (1963). See 1 R. LONG, *supra* note 12, § 11.07A.

41. New Amsterdam Cas. Co. v. Addison, 169 So. 2d 877 (Fla. Dist. Ct. App. 1969).

42. Morris v. Western Cas. & Sur. Co., 421 S.W.2d 19 (Mo. Ct. App. 1967).

43. Insurance Co. of North America v. Electronic Purification Co., 67 Cal. 2d 679, 433 P.2d 174, 63 Cal. Rptr. 382 (1967). In McNally v. American States Ins. Co., 308 F.2d 438 (6th Cir. 1962) it was stated that "[w]e are not persuaded that the average businessman would be unreasonable or lacking in understanding in assuming that the caption phrase "Products—Completed Operations" related to the subject of products liability and that the subdivisions thereof were both germane to such subject. *Id.* at 443.

ance coverage problems in only a very small percentage of cases and the result of the doctrine that any ambiguity in an insurance policy is to be resolved against the insurer.[44]

Nevertheless, the majority of courts that were faced with this coverage question held that the completed-operations provision did not apply to an insured's business if it involved purely service operations.[45] Some courts took an additional step and held that the completed-operations clause did not include a service that was only remotely related to a product.[46] Similarly, if the business of the insured could be severed into operations not related to a product, only those operations that involved a product were subject to the completed-operations exclusion.[47] These decisions violated a cardinal principle of contract law, for they not only ignored the express language of the "operations" definition under "Products Hazard," but also rendered nugatory the whole definition of "completed operations" when considered in light of the activities of an insured clearly engaged in an "operation."[48] The better view, and one more in line with the intent of the policy drafters, was taken by only a handful of courts, which held that the completed operations provision covered all types of operations regardless of the involvement of a product.[49]

The courts that held either of the subdivisions of "Products Hazard" inapplicable in a given case had to face an additional coverage issue concerning what categories of property damage were covered by the policy. The pre-1966 policies contained a clause excluding coverage for:

> Injury to or destruction of . . . any goods or products manufactured, sold, handled or distributed or premises alienated by the

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44. Sorensen, *supra* note 10, at 645.

45. Hendersen, *supra* note 6, at 423 & n.30.

46. Insurance Co. of North America v. Electronic Purification Co., 67 Cal. 2d 679, 433 P.2d 174, 63 Cal. Rptr. 382 (1967).

47. McNally v. American States Ins. Co., 308 F.2d 438, 445-46 (6th Cir. 1962); Bituminous Cas. Corp. v. R & O Elevator Co., 293 F.2d 179, 185 (8th Cir. 1961); Gehrlin Tire Co. v. American Empire Ins. Co., 243 F. Supp. 577 (W.D. Pa. 1964), *aff'd* 348 F.2d 918 (3d Cir. 1965).

48. Newmann v. Wisconsin Natural Gas Co., 27 Wis. 2d 410, 134 N.W.2d 474 (1965).

49. Hendersen, *supra* note 6, at 424. *See* Green v. Aetna Ins. Co., 397 F.2d 614 (5th Cir. 1968)(drill repair service); Orchard v. Argricultural Ins. Co., 228 F. Supp. 564 (D. Or. 1964)(auto parts); Waterman S.S. Corp. v. Snow, 222 F. Supp. 892 (D. Or. 1963); Clauss v. American Auto. & Ins. Co., 175 F. Supp. 641 (D. Pa. 1959); American Policyholders Ins. Co. v. McClinton, 100 N.J. Super. 169, 241 A.2d 462 (Super. Ct. Ch. Div. 1968).

named insured, on work completed by or for the named insured, out of which the accident arises.[50]

This clause indicated the intent of the drafters to insure personal injury or property damage to others, caused by workmanship defects in the insured's product, but not losses arising from customer complaints that the product is worthless or lacking in quality.[51] In essence, it constituted a deductible feature—the deduction being the amount of the overall claim that represented the damage done to the insured's own product or workmanship.

The courts had no problem applying this provision when the product, as an undivided whole, was defective.[52] Nor was there any lack of uniformity in application of the exclusionary clause when, because of defects in products, property damage resulted to things other than products handled by the insured. The insurer was held liable for all property damage except that to the product itself.[53]

An interesting problem did arise, however, in the application of this exclusionary clause to situations in which a product consisted of several component parts, and a defect in only one of these components resulted in damage to the entire product. Was the exclusionary clause intended to exclude coverage for the defective component while holding the insurer liable for the damage to the remainder of the product, or was it intended to exclude coverage for the damage to the total product? Even the insurance underwriters could not agree on the answer to this question.[54] One court, noting this ambiguity, proceeded from the

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50. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3550.

51. Andersen, *supra* note 8, at 443.

52. *See* Vobill Homes, Inc. v. Hartford Acc. and Indem. Co., 179 So. 2d 496 (La. Ct. of App. 1965).

53. *See* Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co., 51 Cal. 2d 558, 334 P.2d 881 (1959) and Hauenstein v. St. Paul-Mercury Indem. Co., 242 Minn. 354, 65 N.W.2d 122 (1954), in which the insurers additionally were held liable for the costs incurred by the insureds in removing the defective products, contrary to the purpose of the exclusionary language. This position has been abandoned in the interpretation of the revised policy. *E.g.*, Biebel Bros., Inc. v. United States Fidelity & Guar. Co., 552 F.2d 1207 (8th Cir. 1975); Chambers Gasket & Mfg. Co. v. General Ins. Co. of America, 29 Ill. App. 3d 998, 331 N.E.2d 203 (1975).

54. In Volf v. Ocean Acc. & Guar. Corp., 50 Cal. 2d 373, 325 P.2d 987 (1958), Justice Carter, in his dissent, noted that a publication of the National Underwriters Co. stated, regarding this issue, that "it is not clear whether the exclusion would deny coverage for damage to the entire piece of equipment or only to the portion causing the damage." *Id.* at 380, 325 P.2d at 992 (Carter, J., dissenting).

principle that exclusionary clauses are to be strictly construed against the insurer, and held that the entire structure, although totally built by the insured, was not the "product" excluded by the policy language. Rather, the clause was held to exclude only damage to the component part that caused the accident.[55] Several other courts adopted this position, although not directly, finding that it was not an unreasonable interpretation of the language that referred to goods or to work out of which an accident arises.[56] Nevertheless, this interpretation contradicted the intent of the drafters, which was to exclude coverage on the entire product, not just the part that failed.[57]

As the field of products liability became increasingly complex, courts were forever seeking expeditious, uniform ways of handling the difficult and often novel issues with which they were faced. In the area of products liability insurance, they uniformly applied the maxim that any ambiguity in the policy language was to be construed against the insurer. Yet, with judicial findings of widespread ambiguity in areas such as completed-operations coverage, the insurance industry was left unable to predict the risks that were being covered, and were therefore liable in many situations in which they did not intend to provide coverage. Courts[58] and commentators[59] recognized the need for a revision of the standard products liability policy in order to lessen the confusion and anomolies resulting from the courts' decisions. The industry responded in 1966 with the revised comprehensive general liability policy.

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55. S.L. Rowland Constr. Co. v. St. Paul Fire & Marine Ins. Co., 72 Wash. 2d 682, 434 P.2d 725 (1967).

56. Blackfield v. Underwriters at Lloyd's, 245 Cal. App. 2d 271, 53 Cal. Rptr. 838 (Dist. Ct. App. 1966). *See* Liberty Bldg. Co. v. Royal Indem. Co., 177 Cal. App. 2d 583, 346 P.2d 444, 2 Cal. Rptr. 329 (Dist. Ct. App. 1960), in which the building contractor, who built the entire house, applied stucco that proved to be defective. The stucco was held to be the "product" to which the exclusion applied. *But see* Pittsburgh Bridge & Iron Works v. Liberty Mut. Ins. Co., 311 F. Supp. 1079 (W.D. Pa. 1970); Kendall Plumbing, Inc. v. St. Paul Mercury Ins. Co., 189 Kan. 528, 370 P.2d 396 (1962).

57. Andersen, *supra* note 8, at 444.

58. *E.g.*, Smedley Co. v. Employers Mut. Liab. Ins. Co., 143 Conn. 510, 515-16, 123 A.2d 755, 758 (1956); Peerless Ins. Co. v. Clough, 105 N.H. 76, 84, 193 A.2d 444, 450 (1963)(Lampron, J., dissenting).

59. *E.g.*, Andersen, *supra* note 8, at 442-46.

III. POST-1966 DEVELOPMENTS

A. Time of the Loss

An insurance policy, like most contracts, remains in effect for a limited, specified period of time. Liability arising from the manufacture or sale of products, however, is not so determinable. A product manufacturer who places his goods in the stream of commerce may face liability, unforeseen or unexpected when the product was first distributed,[60] arising from that product's defective design, defective condition or malfunction. With respect to the insurance designed to cover such liability, it is therefore necessary to analyze when the "loss" giving rise to the liability occurs.

As already stated, the "products-hazard" provision excluded coverage for the "handling or use of, the existence of any condition in . . . goods . . . if the *accident* occurs after the insured has relinquished possession thereof."[61] The question of exactly when an "accident" occurred occasionally arose. Was it at the time of the negligent act or at the time of the occurrence resulting in loss or damage? With products liability insurance, this issue is an important one since damage may occur weeks, months or even years after the wrongful act. In *Lessak v. Metropolitan Casualty Insurance Co.*,[62] the insured unlawfully sold BB shot to a minor, who subsequently injured another away from the insured's premises. The court, noting that the policy did not define the word "accident," construed the language to hold that the accident was not the occurrence of injury, but rather was the unlawful sale of the BB shot.[63] Because the sale occurred at the insured's premises, coverage was provided under the insured's "Premises and Operations" policy. One commentator attributes this holding to the fact that injury or property damage must result from some defective condition in the product itself before the product-hazard exclusion applies.[64] Such an interpretation,

60. The proposed draft of the Uniform Product Liability Act provides that a "product seller may be liable to a claimant for harm caused by the seller's product during the useful safe life of that product. 'Useful safe life' refers to the time during which the product reasonably can be expected to perform in a safe manner." 44 Fed. Reg. 2997 (1979).

61. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3530. *See* note 22 and accompanying text *supra*.

62. 168 Ohio St. 153, 151 N.E.2d 730 (1958).

63. *Id.* at 158, 151 N.E.2d at 734.

64. [1979] 1 PROD. LIAB. REP. (CCH) ¶ 3527.

however, negates the use in the policy of the words "handling or use of."

The rationale in *Lessak*, nevertheless, has been followed.[65] Other courts in similar situations found the existence of two "accidents"—the first being the wrongful sale and the second being the resulting injury.[66] Since the first "accident" occurred on the premises, coverage was found. One court, however, recognized the fallacy of this rationale when it stated:

> Those cases, which rely upon treating a negligent sale as an "accident" in order to find coverage under these circumstances, import to the word something far beyond its normal, popular meaning. In the ordinary affairs of life we would neither call the sale of a product in violation of a statute an "accident," nor reasonably expect others to do so. Such construction seems constrained and labored.[67]

This interpretation appears to be the more practical of the approaches and appears to follow the intentions of the insurance industry.

Under the *Lessak* line of decisions, however, the insurance companies found themselves facing the possibility of covering risk extending for undertermined periods, even years, after the policy expires. In the 1966 revised standard policy, therefore, the word "accident" was replaced by the word "occurrence," which in turn has been defined as follows:

> "Occurrence" means an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured.[68]

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65. *See* St. Paul Fire & Marine Ins. Co. v. Coleman, 316 F.2d 77 (8th Cir. 1963). *But see* Hagen Supply Corp. v. Iowa Nat'l Mut. Ins. Co., 331 F.2d 199 (8th Cir. 1964).

66. *See* Athens v. Hartford Acc. and Indem. Co., 7 Mich. App. 414, 151 N.W.2d 846 (1967); Brant v. Citizens Mut. Auto. Ins. Co., 4 Mich. App. 596, 145 N.W.2d 410 (1966).

67. Cobbins v. General Acc. Fire & Life Assur. Corp., 53 Ill. 2d 285, 292, 290 N.E.2d 873, 877 (1972).

68. 1 R. LONG, *supra* note 12, § 11.01 (Cum. Supp. 1979). This definition was first added in 1966 and then revised in 1973. It is designed to emphasize the intent of the policy draftsmen that, in situations involving a related series of events attributable to the same factor, only one accident or occurrence has transpired and the policy limits are not to be multiplied. *Id.*

By including "accident" in the definition, the underwriters sought to clarify their intent to provide coverage only for losses occurring during the policy period.[69] Not all courts, however, have followed this intention. In *Farm Bureau Mutual Insurance Co. v. Lyon*,[70] the Arkansas Supreme Court construed a pre-1966 policy nine years after the underwriters had sought to lessen confusion surrounding application of policy limits. The court in *Lyon* nevertheless applied the *Lessak* rationale in a case involving the negligent sale of gunpowder to a minor. Since the sale itself, and not a defective product, was the proximate cause of the accident, the product-hazard exclusion was held inapplicable and coverage was provided.[71] The *Lyon* decision, among others,[72] illustrates the effect that pre-1966 cases still have on current decisions of this nature.

An even greater deviation from the underwriters' intentions was recently made by a New York court in *Bernstein v. Crystal Building Corp.*[73] Plaintiff Bernstein brought an action both against the owner of a building (Crystal) in which she was a resident and against a plumber (Arcoy), claiming negligent installation of a sink faucet. While the building was being constructed, Crystal had hired Arcoy as plumbing subcontractor, agreeing to obtain for the latter liability insurance coverage. A revised standard policy was written by the insurer for the period September 14, 1967 to September 14, 1968, in which "completed operations—plumbing" coverage was included. Arcoy finished its "operations" by the end of 1968, the policy was not renewed, and plaintiff was injured on January 19, 1969. Crystal referred the claim to the insurer, which denied coverage because the injuries occurred after the policy had expired. Disregarding any limitation of coverage within the policy, the court approached the issue from an equity viewpoint: "Their [the insurer's] position . . . simply stated, is that if the insured 'negligently' installs a plumbing fixture on a day within the policy period and the item 'holds' long enough so that no one is hurt until after the policy period, they are no longer responsible under that policy."[74] Ques-

69. Sorensen, *supra* note 10, at 647.
70. 258 Ark. 802, 528 S.W.2d 932 (1975).
71. *Id.* at 811, 528 S.W.2d at 937.
72. *E.g.*, W.N. Leslie, Inc. v. Travelers Ins. Co., 264 S.C. 408, 215 S.E.2d 448 (1975).
73. 86 Misc. 2d 885, 383 N.Y.S.2d 181 (N.Y. City Ct. 1976).
74. *Id.* at 888, 383 N.Y.S.2d at 183.

tioning why an insured would add completed-operations coverage if it did not extend beyond the policy period, the court in *Bernstein* held that this endorsement was intended to cover situations such as the one before it. This approach, giving greater weight to the expectations of the insured rather than to the clear and unambiguous language in the policy, has been followed in similar situations in other jurisdictions.[75]

A question regarding time of loss occasionally may arise with property damage, caused by a product, which fully manifests itself long after the damage was initially discovered. This question arose in *United States Fidelity & Guaranty Co. v. American Insurance Co.*[76] The insured, Adams, manufactured bricks that were used in the construction of a house. During the time in question, Adams carried successive products liability insurance policies with three insurance companies. The bricks chipped, flaked or broke during the policy periods of all three insurers. The question arose whether each insurer was liable only for a quantum of damage corresponding to the number of bricks flaking during its period of coverage or whether the insurer during whose period of coverage the damage was first discovered was liable for all damage to the structure occurring thereafter, even though such loss extended beyond its period of coverage. After analyzing the word "occurrence," the court adopted the latter position, holding that "property damage" occurs to the entire structure in the policy period when the damage first becomes apparent and is not equated with the amount of loss that may have occurred in a given policy period.[77] It follows from this decision that the insurer providing coverage when the damage was first discovered would have been equally liable for the entire loss even if there had been no coverage at all during the periods of subsequent flaking.

There have been few decisions[78] directly construing the word "occurrence" as defined in the revised standard policy. As in

75. *See* Atwood v. Hartford Acc. & Indem. Co., 116 N.H. 636, 365 A.2d 744 (1976). *But see* Sandpiper Constr. Co. v. United States Fidelity & Guar. Co., 348 So. 2d 379 (Fla. Dist. Ct. App. 1977).

76. 345 N.E.2d 267 (Ind. Ct. App. 1976).

77. *Id.* at 271.

78. United States Fidelity & Guar. Co. v. American Ins. Co., 345 N.E.2d 267 (Ind. Ct. App. 1976); Oceanonic, Inc. v. Petroleum Distrib. Co., 280 So. 2d 874 (La. Ct. of App. 1973); Singsaas v. Diederich, 307 Minn. 153, 238 N.W.2d 878 (1976); Boggs v. Aetna Cas. & Sur. Co., 272 S.C. 460, 252 S.E.2d 565 (1979). *See also* Scott v. Keever, 212 Kan. 719, 512 P.2d 346 (1973) (construing "accident" as an occurrence under the old policy).

Travelers Insurance Co. v. C.J. Gayfer's & Co.,[79] each court has interpreted this policy language to mean that "an identifiable event other than the causative negligence must take place during the policy period."[80] This interpretation is in accord with the intentions of the drafters and indicates that the revised definition is clear and unambiguous. Although *Bernstein* represents a unique approach to this issue, it is anticipated that as courts become more accustomed to dealing with the revised policy, they will recognize that the intention of the drafters to limit coverage with respect to the time of the loss is clearly stated, and supersedes any contrary intention on the part of the insured.

B. Warranties

As already stated, the pre-1966 products-hazard provision excluded coverage for a "warranty of goods or products manufactured, sold, handled, or distributed by the named insured."[81] In addressing the issue of negligent representations, the courts formed two disparate lines of opinion. One group was reluctant to consider a representation closely related to a sale or service as a separate operation. These courts held that since the negligent representation merged with the completed sale, coverage was excluded unless the insured had purchased the products-hazard endorsement.[82] Other decisions took the position that a negligent representation was an "operation" that was not completed until the representation itself was acted upon.[83] In the same vein, one court treated the negligent representation as "a new operation, separate, complete and distinct from the original operation."[84]

The revised policy attempted to unify the lines of thought regarding warranties and the scope of products liability insurance coverage. One writer states that the revision removes warranty cases from "operation."[85] This statement is somewhat mis-

79. 366 So. 2d 1199 (Fla. Dist. Ct. App. 1979).

80. *Id.* at 1202.

81. See note 22 and accompanying text *supra*.

82. Cravens, Dargan & Co. v. Pacific Indem. Co., 29 Cal. App. 3d 594, 600, 105 Cal. Rptr. 607, 612 (1972); American States Ins. Co. v. Aetna Life & Cas. Co., 379 N.E.2d 510 (Ind. Ct. App. 1978). *See also* Oceanonics, Inc. v. Petroleum Distrib. Co., 280 So. 2d 874 (La. Ct. of App. 1973) (negligent failure to warn).

83. Reed Roller Bit Co. v. Pacific Employers Ins. Co., 198 F.2d 1 (5th Cir. 1952); Waterman S.S. Corp. v. Snow, 222 F. Supp. 892 (D. Or. 1963).

84. Waterman S.S. Corp. v. Snow, 222 F. Supp. 892, 900 (D. Or. 1963).

85. Sorensen, *What A Lawyer Ought to Know About Products Liability Insurance*

leading since the new completed-operations hazard provision excludes "reliance upon a representation or warranty made at any time with respect [to operations]."[86] The warranty language with respect to products and operations is clear and unambiguous. It explicitly denies coverage for bodily injury arising out of reliance on warranties made at any time with respect to an insured's product when the injury occurs away from the insured's premises and after the insured has relinquished possession of the product. Likewise, bodily injuries arising out of representations or warranties made with respect to the insured's operations are excluded "when all operations have been performed by the insured and when the injury occurs away from the insured's premises."[87]

The provision applies to implied as well as express warranties.[88] Furthermore, the "operation" is not extended by warranties, nor is a representation an "operation" in itself.[89] This point is made clear by the language of the "completed operations hazard" definition, which provides that "operations which may require . . . correction, repair or replacement because of any defect or deficiency, but which are otherwise complete, shall be deemed completed."[90] Although the word "negligence" is not specifically mentioned, it has been held that the words "arising out of operations" and "arising out of the named insured's products" in the hazard definitions are "broad enough to exclude bodily injury arising out of operations or products caused to be defective or faulty by negligence."[91]

It is significant in a products liability case that although negligent representations and warranties are excluded from coverage, injury resulting from failure to warn is not.[92] This statement, however, must be qualified. Numerous courts have held that when a defect exists in the product that causes the injury, the mere allegation of failure to warn will not remove the action

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Coverage, 1968 TRIAL LAWYERS GUIDE 322, 326.

86. Sorensen, *supra* note 10, at 646.

87. Jones v. Sears Roebuck & Co., 80 Wis. 2d 321, 330, 259 N.W.2d 70, 74 (1977).

88. Roberts v. P. & J. Boat Service, Inc., 357 F. Supp. 729, 734 (E.D. La. 1973).

89. Jones v. Sears Roebuck & Co., 80 Wis. 2d 321, 259 N.W.2d 70 (1977).

90. *See* Roberts v. P. & J. Boat Service, Inc., 357 F. Supp. 729, 732 (E.D. La. 1973).

91. *Id.* at 735.

92. Templet v. Goodyear Tire & Rubber Co., 341 So. 2d 1248 (La. Ct. of App. 1977); Cooling v. United States Fidelity & Guar. Co., 269 So. 2d 294 (La. Ct. of App. 1972).

from the products-hazard exclusion.[93] The definitions of products hazard and completed-operations hazard, however, do not mention omissions or failure to warn when there is no affirmative duty to do so.[94] Reasoning that the insurer could have expressly excluded failure to warn if it so desired, courts have held that if the injury results from a danger inherent in a product and the danger does not constitute a defect, a cause of action for failure to warn is not excluded by the products-hazard or completed-operations provisions.[95] This is especially noteworthy to practitioners who handle products liability cases since, to insure enforcement of a possible judgment, it is often crucial for a plaintiff to structure his case so that insurance coverage for the defendant is maintained.[96]

C. Products-Hazard Coverage

The 1966 revised comprehensive general liability policy separated the definition of "completed operations" and "products hazard." The purpose of this physical separation was to circumvent the effect of the various decisions that disregarded the products-liability exclusion and thereby mandated coverage when the insured did not deal in a product.[97] The revised products-hazard provision reads as follows:

> "Products hazard" includes bodily injury and property damage arising out of the named insured's products or reliance upon a representation or warranty made at any time with respect thereto, but only if the bodily injury or property damage occurs away from the premises owned by or rented to the named insured and after physical possession of such products has been

93. *See* Bitts v. General Acc. Fire & Life Assur. Corp., 282 F.2d 542 (9th Cir. 1960); Oceanonics, Inc. v. Petroleum Distrib. Co., 280 So. 2d 874 (La. Ct. of App. 1973); Inductotherm Corp. v. New Jersey Mfrs. Cas. Ins. Co., 83 N.J. Super. 464, 200 A.2d 358 (Super. Ct. Law Div. 1964).

94. Templet v. Goodyear Tire & Rubber Co., Inc., 341 So. 2d 1248 (La. Ct. of App. 1977).

95. *Id.*; Cooling v. United States Fidelity & Guar. Co., 269 So. 2d 294 (La. Ct. of App. 1972).

96. If the plaintiff pleads and thereby comes within the scope of an exclusionary clause contained in the policy, he will not jeopardize his cause of action since the defendant is normally the insured rather than the insurer. If the insured is insolvent, however, the plaintiff may find himself forced to institute a second action against the insurance company to recover the unpaid judgment. The suggestion in the text is designed to avoid the necessity of a second action.

97. 1 R. LONG, *supra* note 12, § 11.07A.

relinquished to others.[98]

One commentator stated that it was the intention of the drafters to dispel the confusion that resulted from court decisions construing the old policy as providing two distinct coverages.[99] Products hazard and completed operations have been regarded as essentially different aspects of the same protection, instead of as two distinct coverages.[100] Products-hazard coverage fills the gap that remains after operations are complete.[101]

Such a convoluted explanation, however, in no way assists the practitioner or broker who is attempting to advise a client what coverage he needs to purchase. Since under the revised policy, products-hazard and completed-operations coverages, if desired, must be specifically purchased "by so electing on the face of the policy or by purchasing an endorsement which either adds the coverage to or deletes the exclusion of the coverage under the basic policy,"[102] must a dealer in products who also provides a service purchase both to be adequately covered? It should not be necessary for him to purchase both because the insured should know whether he is engaged in an "operation" or whether he deals in a "product" for the purposes of purchasing the right coverage. Therefore, if and when he is forced to litigate a coverage question, he may be assured that the final adjudication will be founded upon the language of the policy section under which he intended his business activities to fall.

Where then should the dividing line be drawn between products and operations? One commentator has stated that product hazard should include losses resulting from the possession, consumption, or use away from the premises of products manufactured, handled, or distributed by the insured, the possession of which has been relinquished to others.[103] How broadly, however, should this language be construed? To eliminate the often impossible task of determining whether the injury falls within a risk arising out of the product itself, one writer feels that once liability is established under tort law, if a product is the cause in

98. *Id.*
99. Sorensen, *supra* note 85, at 326.
100. Sorensen, *supra* note 10, at 648.
101. *Id.*
102. Hendersen, *supra* note 6, at 418.
103. Sorensen, *supra* note 85, at 326.

fact of the injury, then one should look no further to determine whether the loss falls within the products-hazard provision, provided the accident occurs after the insured has relinquished possession of the product and occurs away from the premises.[104] A supplier of products should be covered for business-related risks if he elects product-hazard coverage and understands that he has no such coverage if he refuses it.[105] Completed operations, on the other hand, would provide coverage for those businesses not dealing in "products."

This interpretation, although theoretically simple, certainly would clear up much of the confusion that for years has surrounded products liability insurance. Courts, however, for the most part have chosen not to adopt this simplified approach. Of course, there is hardly a problem if the insured is merely a wholesaler or retailer of products and engages in no service operations.[106] When the insured's business involves not only the handling of products, but also the furnishing of a service, however minimal, the analysis has not been so clear. In *Novak v. All City Insurance Co.*,[107] plaintiff previously had recovered a judgment against the insured, a restaurant, for injuries she sustained from eating adulterated food. When this judgment went unpaid, she sought recovery from the restaurant's liability carrier. The restaurant clearly provided products (food) and operations (service). The court, holding that coverage was excluded, based its decision on a policy provision that excluded coverage for bodily injury "arising out of the named insured's products."[108] The significance of the opinion is that the court did not even address the fact that operations had been completed.

The approach taken by other courts, however, has been to the contrary. In *Southern Guaranty Insurance Co. v. Scott*,[109] the insured was a dealer of liquid nitrogen, which was purchased from chemical companies and was used as fertilizer. The nitrogen was delivered by the chemical companies and stored in a

104. Hendersen, *supra* note 6, at 428 n.48.

105. *Id.* at 429.

106. *See* Timberline Equip. Co., Inc. v. St. Paul Fire & Marine Ins. Co., 281 Or. 639, 576 P.2d 1244 (1978); Templet v. Goodyear Tire & Rubber Co., 341 So. 2d 1248 (La. Ct. of App. 1977).

107. 43 N.Y.2d 854, 374 N.E.2d 127, 403 N.Y.S.2d 216 (1978).

108. *Id.* at 855, 374 N.E.2d at 127, 403 N.Y.S.2d at 216.

109. 28 Ala. 159, 266 So. 2d 602 (1972).

central storage tank located on the insured's premises. When a customer desired to purchase fertilizer, the liquid was transferred from the central tank to 1,000 gallon "nurse tanks" owned by the insured. These latter tanks were attached to trailers that were used to transport the product to the particular location where it was to be used. The court noted that on some occasions the insured would tow the nurse tanks to customers' farms.[110] The cost of the nitrogen was determined by computing the weight difference in the nurse tank before the customer took it out and after he returned it. Plaintiff in *Scott* had transported the nitrogen to his farm by his own truck. As he was transferring the liquid from the tank to the applicator, the transfer hose ruptured, causing the acidic fluid to spray into his eyes.

The insured in *Scott* had purchased neither products-hazard nor completed-operations coverage. Clearly, coverage should have been excluded under the products-hazard exclusion. The injury resulted from the use of a product handled or distributed by the insured, away from the insured premises and after possession of the nitrogen had been relinquished to the plaintiff. The Alabama court, however, approached the coverage issue from the standpoint of the completed-operations provisions, noting that the insured's "operation" pertaining to the nitrogen involved the furnishing of equipment.[111] It held that since the final weigh-in had not yet been accomplished and the "work" had not been put to its intended use (the nitrogen was not yet fertilizing the crops), the operations were not complete at the time of the injury. The completed-operations exclusion was therefore inapplicable and the insurer was held obligated to defend and indemnify.[112] Numerous other courts have engaged in similar analyses.[113]

As evidenced by the foregoing discussion, courts have made little or no attempt to establish a dividing line between "prod-

110. *Id.* at 161, 266 So. 2d at 604.

111. *Id.* at 164, 266 So. 2d at 607.

112. *Id.* at 166, 266 So. 2d at 609.

113. *E.g.*, Hanover Ins. Co. v. Hawkins, 493 F.2d 377 (7th Cir. 1974) (sale and installation of gas heater); Weiss v. Bituminous Cas. Corp., 59 Ill. 2d 165, 319 N.E.2d 491 (1974)(sale and loading of scrap magnesium); Whitten Oil, Inc. v. Fireman's Fund Ins. Co., 112 N.H. 257, 293 A.2d 757 (1972)(sale and installation of gas tank); Jones v. Sears Roebuck & Co., 80 Wis. 2d 321, 259 N.W.2d 70 (1977)(sale of battery characterized as an operation).

ucts" and "operations."[114] It may be safe to say that one dealing primarily in products need only purchase products-hazard coverage. In light of the *Scott* decision and those following it, however, it is possible that an insured might elect products-hazard coverage, only to have the court analyze the coverage issue under the completed-operations provision, find that the operations were complete, and thereby deny coverage. The insured must be advised of this possibility, and if his business involves products and operations to any appreciable degree, he should include both products-hazard and completed-operations coverages in his liability policy package. Although this result seems somewhat inequitable,[115] it is the only way that the insured can fully assure himself of adequate coverage for the risks that he faces when his products and/or services enter the stream of commerce.

D. Completed-Operations Coverage

Products liability insurance traditionally was not intended to provide coverage for personal injury or property damage arising out of operations that occurred away from the insured's premises and after operations had been completed.[116] The pre-1966 policy, however, failed to define what constituted a "completed" operation, and the court decisions addressing this issue took great pains to find that operations were incomplete. In *Heyward v. American Casualty Co.*,[117] plaintiff contracted to install the plumbing and heating in a housing complex. As each unit

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114. *See* Friestad v. Travelers Indem. Co., ___ Pa. Super. Ct. ___, 393 A.2d 1212 (1978).

115. The insurance underwriters, as part of their risk management, actually encourage most businesses to carry both coverages in an endeavor to avoid litigation, in which they are obligated to defend the insured, concerning which particular coverage applies. As a result, the premiums for product-hazard and completed-operations coverages are rated according to the business activities being insured. For example, if the business primarily involves the sale of products, and operations activities are limited, the premiums for the latter are small per thousand as compared to those for products hazard. Therefore, the conclusion reached above does not in reality pose a financial threat to a small business attempting to make ends meet.

116. Most of the Comprehensive General Liability policies presently being issued, following the 1973 standard policy restructuring, automatically include completed-operations and products-hazard coverages. The additional premiums have been added as a part of the basic CGL premium. The insured may still choose between two coverages, but to do so, he must have one or both excluded by endorsement. 1 R. LONG, *supra* note 12, § 11.01.

117. 129 F. Supp. 4 (E.D.S.C. 1955).

became available for occupancy, the owner of the project rented it to tenants. Before the entire project had been completed, an explosion occurred in one of the completed units and injured the tenants. The court held that since plaintiff had only one contract for the plumbing and heating, which covered the entire project, its "operations" were not complete.[118] The fact that the owner saw fit to take over and attempt to use one or more units before the project was completed did not affect the question of whether plaintiff's operations had been completed.[119] Other courts have used similar analyses in like situations.[120]

In addition to physically separating by eleven paragraphs[121] the definitions of "product hazard" and "completed operations hazard," the 1966 revision clarified the situations in which operations are to be deemed completed. The present policy provides that completion occurs at the earliest of the following times:

> (1) when all operations to be performed by or on behalf of the named insured under the contract have been completed,
> (2) when all operations to be performed by or on behalf of the insured at the site of the operations have been completed, or
> (3) when the portion of the work out of which the injury or damage arises has been put to its intended use by any person or organization other than another contractor or subcontractor engaged in performing operations for a principal as a part of the same project.[122]

It is important for both the insured and the insurer to know on what basis courts will obligate the insurer to defend the insured in a case in which the completed-operations provision is involved. It is a well-settled principle of insurance law that an insurer is obligated to defend an action against its insured if the complaint filed against the insured alleges facts that are potentially within the coverage of the policy.[123] It would seem to follow

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118. *Id.* at 10.

119. *Id.*

120. *E.g.*, General Cas. Co. v. Larson, 196 F.2d 170 (8th Cir. 1952); Daniel v. New Amsterdam Cas. Co., 221 N.C. 75, 18 S.E.2d 819 (1942). The court in *Daniel* held "that the work is complete within the meaning of the insurance contract so long as the workman has omitted or altogether failed to perform some substantial requirement essential to its function, the performance of which the owner still has a contractual right to demand." *Id.* at 77, 18 S.E.2d at 820.

121. 1 R. LONG, *supra* note 12, § 11.07.

122. *Id.*

123. *See, e.g.*, Space Conditioning Inc. v. Insurance Co. of North America, 294 F.

that a complaint that merely alleges that operations were incomplete at the time of injury potentially would render the completed-operations provision inapplicable, thereby obligating the insurer to provide defense for the insured. This result would also expose the insurer to the potential obligation of satisfying a subsequent adverse judgment. Two recent cases,[124] however, have held to the contrary. In *Weiss v. Bituminous Casualty Corp.*[125] the insured argued that since the complaint, in which he was the named defendant, was silent about the scope of his contract for services, the contract, and therefore the plaintiff's operations, potentially were not completed, and the insurer was thereby obligated to defend. In *Shepard Marine Construction Co. v. Maryland Casualty Co.*[126] plaintiff contended that its insurer was required to provide defense since the complaint in the original action alleged that the accident had occurred prior to the completion of operations. In each case the court rejected the insured's argument. The reasoning was stated aptly in *Shepard*:

> Defendant cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. The pleadings are malleable, changeable and amendable. . . .
>
> To restrict the defense obligation of the insurer to the precise language of the pleadings would not only ignore the thrust of the cases but would create an anomaly for the insured.[127]

One writer has suggested that the insurer may, and often must, look behind the third party's allegations to analyze whether, under the facts pleaded, coverage is possible.[128]

Courts that have construed the revised completed-operations hazard provision have uniformly found it clear and unam-

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Supp. 1290 (E.D. Mich. 1968), *aff'd*, 419 F.2d 836 (6th Cir. 1970); McFadyen v. North River Ins. Co., 62 Ill. App. 2d 164, 209 N.E.2d 833 (1965); General Ins. Co. of America v. Palmetto Bank, 268 S.C. 355, 233 S.E.2d 699 (1977); R. KEETON, BASIC TEXT ON INSURANCE LAW 426 (1971).

124. Weiss v. Bituminous Cas. Corp., 59 Ill. 2d 165, 319 N.E.2d 491 (1974); Shepard Marine Constr. Co. v. Maryland Cas. Co., 73 Mich. App. 62, 250 N.W.2d 541 (1977). *But see* Ketona Chem. Corp. v. Globe Indem. Co., 404 F.2d 181 (5th Cir. 1968).

125. 59 Ill. 2d 165, 319 N.E.2d 491 (1974).

126. 73 Mich. App. 62, 250 N.W.2d 541 (1977).

127. *Id.* at 65, 250 N.W.2d at 542 (entire passage quoting Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 276, 419 P.2d 168, 176, 54 Cal. Rptr. 104, 112 (1966)).

128. 14 G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 51:47 (2d ed. Cum. Supp. 1978).

biguous.[129] The first two provisions defining when operations shall be deemed complete are quite similar. Both state, in essence, that an operation is complete when the named insured has fully performed his job contract. The second provision, however, pertains to contracts that are to be performed at a particular job site, which is most often the case in the trade of a contractor or builder.[130] Under these definitions, temporary job interruptions or delay while another trade finishes work would not render operations "complete"; therefore, procurement of the completed-operations hazard would not be required.[131]

Immediately following the three "completion" clauses set forth above, the completed-operations provision states that:

> Operations which may require further service or maintenance work, or correction, repair or replacement because of any defect or deficiency, but which are otherwise complete, shall be deemed completed.[132]

This clause qualifies each of the three definitions of when an operation is deemed completed. It raises an interesting and significant question when considered in conjunction with the first definition. Does the completion of operations or fulfillment of obligations under a contract require that the finished product actually perform as intended? In other words, is an operation complete when the finished product actually functions properly, or rather when it ought to function properly? The qualification leads to the conclusion that operations are complete when the finished product *should* work, since there is no time limitation for when repair or replacement of defective work must be performed. If repair or replacement may be made immediately after the operation is "otherwise complete," then essentially there is no requirement that the operation must ever actually work to be "complete." This reasoning conflicts with that of the older line of cases, although not addressing this precise issue, in which it

129. *See* Travelers Ins. Co. v. C.J. Gayfer & Co., 366 So. 2d 1199 (Fla. Dist. Ct. App. 1979); Prieto v. Continental Ins. Co., 358 So. 2d 851 (Fla. Dist. Ct. App. 1978); Ronald Bouchard, Inc. v. Hartford Acc. & Indem. Co., 369 Mass. 846, 343 N.E.2d 372 (1976); Security Ins. Co. of Hartford v. Kaye Milling Supply, Inc., 297 Minn. 348, 211 N.W.2d 519 (1973); Abco Tank & Mfg. Co. v. Federal Ins. Co., 550 S.W.2d 193 (Mo. 1977); Jones v. Sears Roebuck & Co., 80 Wis. 2d 321, 259 N.W.2d 70 (1977).

130. Sorensen, *supra* note 85, at 327.

131. *Id.*

132. Sorensen, *supra* note 10, at 646.

was held that operations are incomplete if the insured "failed to perform some substantial requirement essential to its functioning, the performance of which the owner still has a contractual right to demand."[133]

This reasoning also is contrary to the holding of the only recent case that has considered this particular question. In *Abco Tank & Manufacturing Co. v. Federal Insurance Co.*,[134] plaintiff entered into a contract in January 1971 to install a liquid-propane heating facility at a nearby plant. Abco designed the facility but obtained the components from other suppliers. All necessary components were connected and installed, and it was determined in August 1971 that the system was operable. In October 1971 the facility was checked and retested, resulting again in a determination that all components were functioning. During a third test in December, under colder conditions, the system failed after brief use because of a defective vaporizer. In February 1972, when the manufacturer of this component was attempting to adjust the vaporizer, the heating facility exploded, causing substantial property damage to the plant. The vaporizer was subsequently replaced and from that time on, the facility functioned as required without mishap.

Abco had not purchased completed-operations hazard coverage. Defendant insurer denied coverage and contended that the operations, which were otherwise complete, were not rendered incomplete by the necessity of having to repair or replace the vaporizer. The court disagreed, holding that Abco contracted to install a heating facility that, when completed, *would* be (rather than *should* be) capable of functioning as required.[135] Since it was not until after another vaporizer had been installed that the facility *could* be used, it was not until then that Abco's operations were "completed" within the meaning of the policy.[136]

Although this holding appears to contradict the language of the completed-operations provisions, it illustrates a court's willingness to twist the intentions of the insurer to find coverage for the insured. The *Abco* decision, however, may be a signal that the "repair or replacement" qualification needs further refining

133. Daniel v. New Amsterdam Cas. Co., 221 N.C. 75, 77, 18 S.E.2d 819, 820 (1942).
134. 550 S.W.2d 193 (Mo. 1977).
135. *Id.* at 199.
136. *Id.*

to resolve the conflict with the first of the three completed-operations definitions.

The third definition under the completed-operations hazard states that operations are deemed complete when the portion of the work out of which the loss arises has been put to the use intended. This clause was inserted partly in response to decisions such as *Heyward v. American Casualty Co.*,[137] in which the court, in rejecting the insurer's claim of exclusion, observed that the insurer was in effect attempting to amend its policy to preclude coverage "if the accident or occurrence takes place after *any portion or part of* such operations have been completed."[138] The new clause, however, also seems to have been based on the proposition that if there is a practical acceptance by the proprietor of a product upon conclusion of the contractor's work, the liability of the contractor to third persons ceases and the responsibility for maintaining or using the product shifts to the proprietor.[139]

The courts have, for the most part, sided with the insurer in excluding coverage for the insured after the owner or a third party has put the work product to its intended use. Courts have done so even with construction work in commercial or public buildings,[140] and in businesses in which equipment is used while construction is ongoing.[141] In *Security Insurance Co. of Hartford v. Kaye Milling Supply, Inc.*,[142] the owner secured permission from Kaye to dry a shipment of soybeans in a newly constructed bin. Shortly after this bin was filled, a supporting leg collapsed, dropping the tower, bin and grain dryer to the ground. More than 450 man-hours of work remained before actual completion of this particular bin. Additionally, there was evidence that performance of some of this work might have prevented the accident. In denying coverage for the insured, the court noted that

137. 129 F. Supp. 4 (E.D.S.C. 1955).

138. *Id.* at 10.

139. Southwestern Bell Tel. Co. v. Travelers Indem. Co., 252 Ark. 400, 403, 479 S.W.2d 232, 234 (1972). *Cf.* Rutledge v. Dodenhoff, 254 S.C. 407, 175 S.E.2d 792 (1970) (holding that in the sale of a new house by the builder-vendor, there arises an implied warranty of habitability and good workmanship "irrespective of any fault" on the part of the builder).

140. Casey v. Employers Nat. Ins. Co., 538 S.W.2d 181 (Tex. Civ. App. 1976)(when the commercial building construction project was only 75 percent complete and the area in which the injury occurred had been accepted and had been put to its intended use).

141. Security Ins. Co. of Hartford v. Kaye Milling Supply, Inc., 297 Minn. 348, 211 N.W.2d 519 (1973).

142. 297 Minn. 348, 211 N.W.2d 519 (1973).

the "damage did not arise out of negligence, incompetence, or defects in the process of actually erecting the structure."[143] Rather, the damage resulted from the precise "use" for which the bins were constructed.[144] Along the same lines, another court held that an operation that, after acceptance, results in property damage is not rendered incomplete by the insured's failure to install a particular component, if such failure bears no relation to the accident.[145]

This particular section of the completed-operations definitions is one of the few areas in which courts faced with products liability coverage issues have strictly construed the policy language to find for the insurance company. In *Martinez v. Villa Construction Corp.*[146] plaintiff's family moved into a new house constructed by the defendant. Three months later, plaintiff, a two-year-old child, pushed open the door at the bottom of the basement stairs and entered the basement where gasoline was stored. The gasoline ignited, causing the child to suffer serious burns. It was undisputed that the door latch was negligently installed. The trial court, finding for the insured defendant, concluded that the intended use of the door was to provide a barrier against the entry of minor children into the basement. The door failed to fulfill this use, rendering incomplete the work out of which the accident arose. The appellate court reversed, noting that basement doors serve purposes other than to provide a child-proof barrier and that a properly working latch is only incidental to the fulfillment of the purposes.[147] Holding that as a "barrier" a door is also designed to be opened, "else a wall would suffice,"[148] it denied coverage.

South Carolina, however, reached the opposite result in a similar situation. In *W.N. Leslie, Inc. v. Travelers Insurance Co.*,[149] the McDaniel family moved into a new house on January

143. *Id.* at 354, 211 N.W.2d at 522.

144. *Id. See also* Hanover Ins. Co. v. Hawkins, 493 F.2d 377 (7th Cir. 1974).

145. Aetna Cas. & Sur. Co. v. Rothman, 331 So. 2d 81, 86 (La. Ct. of App. 1976).

146. 38 Colo. App. 302, 563 P.2d 954 (1976), *aff'd sub nom*, Martinez v. Hawkeye Security Ins. Co., 576 P.2d 1017 (Colo. 1978).

147. 38 Colo. App. at 304, 563 P.2d at 956.

148. *Id.* The state supreme court agreed, stating "a door is a movable piece of firm material or structure supported usually along one side and swinging on pivots or hinges. . . by means of which an opening *may be closed or kept open* for passage *into or out* of a . . . room . . . ." 576 P.2d at 1020 (emphasis in original).

149. 264 S.C. 408, 215 S.E.2d 448 (1975).

24, 1967. Two days later, Mrs. McDaniel, while descending from the attic, was injured when the folding stairway collapsed. It was discovered that the upper end of the stairway had simply been jammed into the stairwell frame without being attached by nail, screw or bolt. W.N. Leslie, the insured contractor, settled the suit with the injured woman and then instituted action seeking reimbursement from its liability carrier. The contractor did not have completed-operations coverage. The insurer contended that since the stairway had been "put to its intended use," it was "completed" within the policy language when the injury occurred, and coverage was thereby excluded. The South Carolina Supreme Court disagreed, holding that the slight use to which the stairway had been put prior to the injury was not its "intended use" within the contemplation of the policy.[150]

The *Kaye Milling* and *Martinez* cases indicate a willingness on the part of most courts to read the "intended use" clause literally and hold that any intended use of the operation brings the insured within the third definition of the completed-operations provision. *Leslie,* however, is the exception. Since this is the only South Carolina case in which this revision[151] of the standard CGL policy has been construed, the insurance company attorney should step lightly when entering a court of this state on a claim involving completed-operations coverage.

As with the products-hazard clause,[152] it is possible in pleading to circumvent the completed-operations provisions so that the insured's coverage will be maintained. In situations involving contractors or builders, one court has held that allegations of negligence in supervising, maintaining and exercising control of the premises under construction and allegations of the failure to warn of a dangerous condition are "within the contemplated

150. *Id.* at 415, 215 S.E.2d at 451. It is interesting that, despite the language of the third "completion" definition, the court in *Leslie* still charged the jury "that work is not deemed completed within the meaning of an insurance contract so long as the workmen have omitted or altogether failed to perform some substantial requirement essential to its functioning, the performance of which the owner has a contractual right to demand." *Id.* at 414, 215 S.E.2d at 450. *See also* Whitten Oil, Inc. v. Fireman's Fund Ins. Co., 112 N.H. 257, 293 A.2d 757 (1972).

151. Only two other South Carolina cases have addressed any of the other 1966 revisions to the CGL standard policy. *See* Boggs v. Aetna Cas. & Sur. Co., 272 S.C. 460, 252 S.E.2d 565 (1979); General Ins. Co. of America v. Palmetto Bank, 268 S.C. 355, 233 S.E.2d 699 (1977). Both cases construed the work "occurrence."

152. See notes 92-96 and accompanying text *supra.*

risks,"[153] and therefore, outside the completed-operations exclusion provision.

IV. EXCLUSIONS

A. *Damages Covered*

It is not the purpose of products liability insurance to provide coverage for all property damage arising out of the insured's products or operations. Rather, the insurance industry places upon the insured, as a risk of doing business, the obligation to repair or replace his own defective work or defective product.[154] In this respect, the revised policy includes a provision that states that the policy does not apply

> (m) to *property damage* to work performed by or on behalf of the *named insured* arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.[155]

It has been noted that only damage arising out of the specified causes is excluded from coverage by this provision. Damage arising in another manner is not.[156] With builders or general contractors, however, the entire structure is often the "work product," and therefore, any damage to the structure itself is not covered by the insured's liability policy.[157] This may generate confusion among contractors who purchase completed-operations hazard coverage with the belief that such coverage also insures their completed structure. Damage to the insured's work product is excluded from the policy altogether. Exclusion (m) does not create an ambiguity when applied to completed operations.[158] The work-product exclusion merely limits completed-operations coverage to the extent that damage to the insured's completed work does not fall within the policy's coverage.[159]

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153. Kincaid v. Simmons, 66 App. Div. 2d 928, 414 N.Y.S.2d 407 (1979).

154. *See* Vobill Homes, Inc. v. Hartford Acc. & Indem. Co., 179 So. 2d 496, 497 (La. Ct. of App. 1965).

155. Sorensen, *supra* note 10, at 647.

156. Slate Constr. Co. v. Bituminous Cas. Corp., 228 Pa. Super. 1, 323 A.2d 141 (1974).

157. *See* B.A. Green Constr. Co., Inc., v. Liberty Mut. Ins. Co., 213 Kan. 393, 517 P.2d 563 (1973).

158. Southwest Forest Indus., Inc. v. Pole Bldgs., Inc., 478 F.2d 185 (9th Cir. 1973).

159. *Id.*; Engine Service, Inc. v. Reliance Ins. Co., 487 P.2d 474 (Wyo. 1971).

Similarly, the revised policy includes a provision excluding coverage for

> *(l)* the property damage to the named insured's products arising out of such products *or any part of such products.*[160]

The italicized portion of this provision was added mainly in response to earlier cases[161] in which it was held that this exclusion did not apply to the entire product if only a component part was defective. These cases instead ruled that the provision applied only to the component part that caused the accident. By adding the words "or any part of such products," the underwriters sought to emphasize that the exclusion applies to damage to the whole product of the insured or to any part thereof. One recent case has held that the words "insured's products," as used in this provision, refer to that in which the insured trades or deals, and not all goods handled by an insured in the process of completing its business function.[162]

The decisions construing exclusion *(l)* have, for the most part, recognized and followed the intentions of the underwriters.[163] There have, however, been exceptions. In *Cotton States Insurance Co. v. Diamond Housing Mobile Homes*[164] a mobile home sold by the insured was damaged by fire caused by a defective furnace. Despite the revised language of provision *(l)*, the court found that it was unclear whether the exclusion applied only to the part of the entity (the furnace) that caused the damage or to the entire entity (the mobile home) that the insured sold.[165] Construing this ambiguity against the insurer, the court held that the policy provided coverage for any property damage, except for the value of the "product" within the mobile home that caused the fire.[166] It is noteworthy that the *Cotton States* decision relied heavily on the reasoning of earlier cases construe-

160. Sorensen, *supra* note 10, at 647 (emphasis added).

161. Pittsburgh Bridge & Iron Works v. Liberty Mut. Ins. Co., 444 F.2d 1286 (3d Cir. 1971); S.L. Rowland Constr. Co. v. St. Paul Fire & Marine Ins. Co., 72 Wash. 2d 682, 434 P.2d 725 (1967).

162. Paxton-Mitchell Co. v. Royal Indem. Co., 279 Or. 607, 569 P.2d 581 (1977).

163. *E.g.*, Biebel Bros., Inc. v. United States Fidelity & Guar. Co., 522 F.2d 1207 (8th Cir. 1975); Adams Tree Serv. v. Hawaiian Ins. & Guar. Co., 117 Ariz. 385, 573 P.2d 76 (1977).

164. 430 F. Supp. 503 (N.D. Ala. 1977).

165. *Id.* at 507.

166. *Id.* at 508.

ing policies that did not include the term "or any part of such products." The "damage to the work performed" and "damage to the product" exclusions have, almost without exception, presented no difficulty to the courts that have addressed them. The *Cotton States* decision, however, illustrates the ever-present possibility that a court will, in a given situation, find ambiguity in the policy language and construe such ambiguity against the insurer. The lawyer must always be mindful of this possibility when evaluating the client's case.

B. The Business-Risk Exclusion

Neither the revised CGL policy, nor its predecessors, was ever intended to provide coverage for business know-how.[167] The 1966 standard policy excluded coverage for:

> (k) . . . *bodily injury* or *property damage* resulting from the failure of the *named insured's products* or work completed by or for the *named insured* to perform the function or serve the purpose intended by the *named insured*, if such failure is due to a mistake or deficiency in any design, formula, plan, specifications, advertising material or printed instructions prepared or developed by any *insured*; but this exclusion does not apply to *bodily injury* or *property damage* resulting from the active malfunction of such products or work.[168]

One writer anticipated that the courts would find this provision troublesome because it seems to restore products coverage taken away by the clause that proceeds it.[169] The New York Court of Appeals agreed, stating that "[a]gain, 'active malfunctioning' seems descriptive of all that is excluded from coverage. If underwriters know what this so-called standard form clause means, the average insured probably does not."[170]

As a result of problems created by the ambiguity of the 1966 policy language, the business-risk exclusion was revised in 1973. This exclusion, in its present form, provides as follows:

> This policy does not apply to loss of use of tangible property which has not been physically injured or destroyed result-

167. Sorensen, *supra* note 85, at 328.
168. Sorensen, *supra* note 10, at 647.
169. Sorensen, *supra* note 85, at 328.
170. Sturges Mfg. Co. v. Utica Mut. Ins. Co., 37 N.Y.2d 69, 332 N.E.2d 319, 371 N.Y.S.2d 444 (1975).

> ing from (1) a delay in or lack of performance by or on behalf of the named insured of any contract or agreement, or (2) the failure of the named insured's products or work performed by or on behalf of the named insured to meet the level of performance, quality, fitness or durability warranted or represented by the named insured;
>
> but this exclusion does not apply to loss of use of other tangible property resulting from the sudden and accidental physical injury to or destruction of the named insured's products or work performed by or on behalf of the named insured after such products or work have been put to use by any person or organization other than an insured.[171]

The exclusion is directed toward "loss of use" claims involving tangible property that has not been physically damaged. The apparent intent of the drafters is that no distinction is to be made between production errors by employees and design errors by management. The exclusion, rather, is directed to areas of "business risk" when the insured is the best judge of the risk involved and should, accordingly, bear the loss.[172]

With respect to loss-of-use coverage, this revised exclusion appears to provide for a broader scope of coverage than the 1966 policy.[173] There is little authority, however, upon which to base this conclusion. In *St. Paul Fire & Marine Insurance Company v. Cross*,[174] decided in 1978, the California Court of Appeals held that the business risk exclusion precluded coverage for a claim brought by a homeowner against a contractor for failure to construct a home in a workmanlike manner. Although the defective materials and workmanship concedely produced an inferior home, giving rise to loss-of-use damages, the court ruled that "poor workmanship on the delivered product is not 'property damage' within the terms of the general comprehensive liability policy."[175] An analogous situation was presented in *Hamilton Die Cast, Inc. v. United States Fidelity & Guaranty Company*,[176] in which a customer sued the insured for failing to comply with a contract for tennis racket frames, which the insured had with-

171. 1 R. LONG, *supra* note 12, § 11.10.
172. *Id.*
173. *Id.*
174. 80 Cal. App. 3d 888. 145 Cal. Rptr. 836 (1978).
175. *Id.* at 894, 145 Cal. Rptr. at 839.
176. 508 F.2d 417 (7th Cir. 1975).

drawn from the market because of design defects. Arguably, this could be viewed as property damage within the terms of the CGL insurance policy, since the finished product (the tennis racket) was damaged by reason of the incorporation of the defective part (the frame). The Seventh Circuit rejected this contention, however, and required a stricter showing of physical harm.[177]

In contrast, in *International Hormones v. Safeco Insurance Company of America*,[178] the insured, a manufacturer of hormone suspensions, had sold defective suspensions resulting in a Food and Drug Administration-ordered recall of a third party's product. The New York Supreme Court held that the exclusion did not apply "where the product has become a part of, or has been integrated into, another product of a third party."[179] This divergence of opinion among the courts apparently results from the degree of strictness used in construing the policy terms. The New York view is certainly justifiable, since a product that has a defective component incorporated into it is clearly physically damaged. At the same time, however, the California and Seventh Circuit view that a defective part that causes no further physical damage is not sufficient to escape the exclusionary clause is clearly warranted by a strict reading of the policy.

Other courts have faced this issue in construing the "active malfunction" requirement of 1966 policy,[180] under which design errors resulting in mere passive failure of the insured's product to perform as intended are regarded as the insured's normal business risk and are excluded from coverage, while design errors that cause some positive or active harm (designated as "active malfunction"), deemed extraordinary in the insured's business, are covered.[181] Some of the hypotheticals appearing in the commentaries[182] dealing with this provision show that the policy is not intended to cover liability resulting from the faulty design of an insecticide that fails to kill insects, a hair tonic that fails to

177. *Id.* at 419.

178. 57 App. Div. 2d 857, 394 N.Y.S.2d 260 (1977).

179. *Id.* at 857, 394 N.Y.S.2d at 261.

180. See note 168 and accompanying text *supra*.

181. American Employers' Ins. Co. v. Maryland Cas. Co., 509 F.2d 128, 130 (1st Cir. 1975). *See also* 1 R. LONG, *supra* note 12, § 11.10; Hendersen, *supra* note 6, at 440.

182. *See, e.g.*, 1 R. LONG, *supra* note 12, § 11.10; Elliott, *supra* note 11; Sorensen, *supra* note 10; Sorensen, *supra* note 85; Tarpey, *The New Comprehensive Policy: Some of the Changes*, 33 INS. COUNSEL J. 223 (1966).

prevent baldness, or a rust inhibitor that fails to inhibit rust.[183] On the other hand, the active malfunction exception is intended to apply to provide coverage for liability resulting from an insecticide that harms crops, a hair tonic that causes a scalp rash, or a rust inhibitor that corrodes a radiator to which it is applied.[184]

The question arises whether any physical damage to property other than the insured's products or work product will constitute an active malfunction. In *Haugan v. Home Indemnity Co.*,[185] the plaintiff designed and constructed an airplane hanger, the foundation of which cracked. Denying coverage, the court applied exclusion (m) (excluding damage to the work performed). In dictum, however, it was stated:

> The same reasoning and the same result applies to the exception relating to "active malfunctioning" of products or work appearing in exclusion (k). This exception is likewise limited by the basic exclusion (m). It means there is no liability coverage afforded by the policies for damages caused by and confined to the insured's own work or product. However, when the insured's work or product actively malfunctions and causes damage to other property coverage is afforded.[186]

Similarly, in *Kyllo v. Northland Chemical Co.*[187] the court held the active-malfunction exception inapplicable absent "actual physical damage caused by the application of the product."[188] Despite the language of these cases, one court has stated that while physical damage to property other than the insured's product or work is *necessary* for a finding of active malfunctioning, the mere showing of such damage is not in itself sufficient to come within this exception to exclusion (k).[189]

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183. *See* American Employers' Ins. Co. v. Maryland Cas. Co., 509 F.2d 128, 130 (1st Cir. 1975).

184. *Id.*

185. 86 S.D. 406, 197 N.W.2d 18 (1972).

186. *Id.* at 413, 197 N.W.2d at 22. It would seem to follow that the same reasoning applies to the active malfunctioning of the insured's products and exclusion *(l)* (damage-to-the-product exclusion).

187. 209 N.W.2d 629 (N.D. 1973).

188. *Id.* at 632.

189. American Employers' Ins. Co. v. Maryland Cas. Co., 509 F.2d 128, 131 n.3 (1st Cir. 1975).

C. *The "Sistership" Exclusion*

Although products liability insurance covers damages for bodily injuries and property damage caused by the insured's product that was defective or that failed, it was never intended that the insurer would be saddled with the cost of preventing such defects or failures.[190] In an attempt to exclude such coverage, the 1966 standard policy revision added exclusion (n), the "sistership" exclusion, which provides that the policy does not apply

> (n) to damages claimed for the withdrawal, inspection, repair, replacement, or loss of use of the named insured's products or work completed by or for the named insured or of any property of which such product or work form a part, if such products, work or property are withdrawn from the market or from use because of any known or suspected defect or deficiency therein.[191]

It is clear that if the insured suspects that all or a portion of his products may be defective and thus constitutes a potential source of injury, the cost of and any liability resulting from his withdrawal of such products from the market is excluded from coverage.[192]

A problem has arisen, however, when a third party has incorporated the insured's product as a component in a larger product. When the insured's component fails or proves defective, the third party is forced to withdraw and correct the defect in the larger product, and subsequently brings suit against the insured for the costs and resulting liability. The courts are split on whether coverage for liability incurred by the insured in this situation is excluded under provision (n). One line of cases has taken the position that the exclusion applies only if the withdrawal is instituted by the insured himself.[193] When the product

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190. 1 R. LONG, *supra* note 12, § 11.11.

191. *Id.* Indeed, the provision makes it a condition of the insurer's liability that the insured "promptly take at his expense all reasonable steps to prevent other bodily injury or property damage from arising out of the same or similar conditions, but such expense shall not be recoverable under this policy." Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co., 34 N.Y.2d 356, 361, 314 N.E.2d 37, 38, 357 N.Y.S.2d 705, 707 (1974).

192. Elliott, *supra* note 11, at 12-9. *See also* International Hormones, Inc. v. Safeco Ins. Co. of America, 57 App. Div. 2d 857, 394 N.Y.S.2d 260 (1977).

193. *See* Arcos Corp. v. American Mut. Liab. Ins. Co., 350 F. Supp. 380 (E.D. Pa. 1972); International Hormones, Inc. v. Safeco Ins. Co. of America, 57 App. Div. 2d 860,

is recalled by a third party, the exclusion is inapplicable and coverage is maintained. In so holding, the New York Court of Appeals, in *Thomas J. Lipton, Inc. v. Liberty Mutual Insurance Co.*,[194] noted that to do otherwise would render products liability coverage nearly illusory:

> It is persuasive that the obvious intent of Gioia [the insured] and Liberty Mutual [the insurer] . . . was to afford Gioia substantial economic protection from exposure to claims of third parties against Gioia in consequence of defects in Gioia's products. To say that the categories of damages claimed here by Lipton [the third-party recaller] do not fall within such coverage would appear to exclude what, as a practical matter, would usually be some of the largest foreseeable elements of such damage.[195]

Moreover, finding ambiguity in the construction urged by the insurer, the court held the exclusion inapplicable.

Other courts, however, have found it immaterial that the withdrawal was not made by the insured.[196] It is noteworthy that in *Elco Industries, Inc. v. Liberty Mutual Insurance Co.*,[197] the court stated that, regardless of who institutes the recall, the component must be so intertwined with the product into which it is incorporated that the component's defect and subsequent repair or replacement necessarily results in damage to the completed product.[198] If the recall and repair of the defective component do not require expenditures greater than those necessary merely to replace the component itself, and the defective part results in no damage to other parts of the larger product, the court in *Elco* suggested that exclusion (n) would be inapplicable.[199]

It follows from these decisions that, if the insured discovers defects in his products, it may necessarily be to his advantage to

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394 N.Y.S.2d 260 (1977); Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co., 34 N.Y.2d 356, 314 N.E.2d 37, 357 N.Y.S.2d 705 (1974).

194. 34 N.Y.2d 356, 314 N.E.2d 37, 357 N.Y.S.2d 705 (1974).

195. *Id.* at 362, 314 N.E.2d at 39, 357 N.Y.S.2d at 708.

196. Hamilton Die Cast, Inc. v. United States Fidelity & Guar. Co., 508 F.2d 417 (7th Cir. 1975). *See also* Elco Indus., Inc. v. Liberty Mut. Ins. Co., 46 Ill. App. 3d 936, 361 N.E.2d 589 (1977).

197. 46 Ill. App. 3d 936, 361 N.E.2d 589 (1977).

198. *Id.* at 939, 361 N.E.2d at 591.

199. *Id.*, 361 N.E.2d at 591-92. *See also* Arcos Corp. v. American Mut. Liab. Ins. Co., 350 F. Supp. 380 (E.D. Pa. 1972).

sit back and allow a third party higher on the retail chain to institute the product's recall. If the insured withdraws the product, he unquestionably will bear the expense and "damages claimed" resulting from the withdrawal, since coverage for such liability is clearly excluded by exclusion (n). If he waits for a third party to initiate the recall, he still faces a risk that is equally great. Depending on the jurisdiction, however, there is the possibility that the court will find exclusion (n) inapplicable and the insurer will be bound to pay the judgment. As indicated by the conditions in some policies that the insured "shall promptly take at his expense all reasonable steps to prevent other bodily injury or damage from arising out of the same or similar conditions,"[200] this inaction by the insured evidently is not what the "sistership" exclusion was intended to elicit. This conclusion again may intimate that the standard policy needs further revision to clarify the intention of the underwriters.

V. CONCLUSION

The 1966 revision of the standard comprehensive general liability policy sought to reduce the confusion and ambiguity that for years had surrounded the interpretation of prior policies. To a large extent, this purpose was accomplished. In so doing, however, the underwriters created certain new problems related to the scope of coverage provided by the revised policy. The purpose of this Note has been to delineate the approaches that the courts have taken in confronting these problems, and the ways that they have been resolved. Defense attorneys and house counsel owe it to their clients to recognize policy coverage questions and to see that their clients secure and pay for only the coverage they need. Plaintiff's lawyers likewise have a duty to their clients to recognize the legal theories that have proven successful when these coverage questions have been litigated. It is hoped that this article will be of some assistance to the bar in fulfilling these obligations.

William Brantley Harvey, III

200. Thomas J. Lipton, Inc. v. Liberty Mut. Ins. Co., 34 N.Y.2d 356, 361, 314 N.E.2d 37, 38, 357 N.Y.S.2d 705, 707 (1974).